Commerce Commission Fibre Input Methodologies Submission

28 January 2020

1 Executive Summary

The Commerce Commission's decisions regarding Input Methodologies (IMs) under the new Part 6 of the Telecommunications Act (Act) will impact the services and costs of both fixed and wireless products for consumers.

Recognising the market power of Chorus and LFCs, the Act requires the Commission to put in place a regulatory regime that limits the ability of these companies to extract excessive profits and ensure prudent and efficient investment for the delivery of consumer services. The IMs set the frameworks for those decisions.

Getting these wrong could mean distortions in competition, higher prices and poorer quality services for end-users. These distortions could be locked in for two or more regulatory periods given the seven-year cycle for the statutory review of the IMs.

2degrees is especially concerned to ensure that under the final regulation the Commission puts in place, framed by the IMs:

- ICABS and DFAS are appropriately regulated for mobile services under the new Part 6;
- Competition across multiple technologies is not undermined;
- Chorus is not handed windfall profits at the expense of RSPs and end-users; and
- Quality regulation sets and measures appropriate standards and metrics to ensure wholesale agreements with LFCs support great, ongoing quality services to end-users.

With the time and resources available we have not been able to review and respond to all the details and matters encompassed in the Commission's substantial draft Reasons Paper and draft Determination.

We note at a high-level:

- We agree with many aspects of the Commission's draft decision, including the Commission's overall legal interpretation (definition of financial losses aside) and general decision-making framework, and explicit clarification to stakeholders that FFLAS includes ICABS.
- We also consider the Commission is on sound grounds to adopt the Part 4 WACC IM approach[1] and a mid-point WACC.
- We agree with the seven quality dimensions identified by the Commission and with the Commission's view that existing contracts are a useful starting point for quality regulation.
- Competition is a fundamental consideration and difference to the existing provisions of Part 4 of the Commerce Act (Part 4) that need to be appropriately considered. We support the economic framework including not just economic principles and an incentive framework, but also 'competition screening' questions to ensure all decisions consider the requirement of section 166(2)(b) to promote competition where this would be in the long-term benefit of end-users in all telecommunication markets. We agree competition is an important consideration for decisions in each of the Asset valuation IM, Cost Allocation IM, Chorus Capex IM and Quality IM.

[1] We have not been able to review the Commission's views on asset beta given time constraints.

- The 2022 deadline appears to be driving an overly generous approach to Chorus on many matters, including granting discretion to the player with high market power without safeguards. The less prescriptive approach the Commission is proposing favours Chorus – with significant and material risk that Chorus won't be "limited in their ability to extract excessive profits". It also does not provide industry certainty, which the IMs are supposed to deliver and which RSPs (and we understand Chorus) seek.

In our view, the Commission needs to:

- Be more prescriptive and so provide greater certainty for stakeholders;
- Provide better regulatory oversight, particularly in the first regulatory period;
- Ensure cost allocation does not allow an excessive amount of costs to be loaded on FFLAS, and ensure Chorus is not allowed to double recover from copper and fibre;
- Address incorrect treatment of financial losses;
- Remove the proposed asset stranding compensation provisions;
- Require Chorus to adequately consult on the development of any Supplier and Capex proposals;
- Tighten Chorus Capex IM requirements; and
- Ensure metrics and subsequent determinations are set correctly so end-users get the quality of service that will be demanded. At a minimum, the Quality IM needs to give the Commission oversight of the process by which Chorus and the LFCs change terms and conditions in wholesale agreements.

Specific Changes required

We have identified a number of changes to the draft Commission IM approach, which are required to meet or better meet the statutory purpose of the regime. These are summarised in the table below.

Input Methodology	Change(s) required
General	• Adoption of '**safe-guard' mechanisms** to protect against risks arising from limited implementation timeframes: If the Commission considers Independent Verification cannot be undertaken for the first regulatory period, then at a minimum the Commission should: – undertake its **own review;** and/or – consider a more **abbreviated/focussed independent verification** e.g. looking at a sample of Chorus' cost forecasts; and/or – adopt **more permissive re-opener provisions** so that the price-quality path can be adjusted if actual capex and/or opex is below the levels in proposals and allowed for in Chorus' price path. • **Additional Chorus consultation requirements:** Chorus should be required to consult on all Supplier and Capex proposals prior to submission to the Commission. The consultation requirements should include a requirement for Chorus to demonstrate: the extent to which and how its engagement with its customers and other stakeholders influenced/impacted on its proposals; and that its proposals support

Input Methodology	Change(s) required
	the objective to supply FFLAS of a quality that reflects end-user demands. • The Commission should undertake a **clause-by-clause review of new Part 6 IMs versus Part 4 IMs** to ensure that there are no inappropriate gaps or emissions in the Part 6 IMs, and that there is justification for all key differences (for example, the Chorus Capex IM doesn't have an explicit requirement for Chorus to undertake a quantified Investment Test, or to evaluate its capex proposals against alternatives).
Asset Valuation IM	• Financial losses need to be determined on an incremental cost basis and must exclude shared and common costs to avoid over-compensation and violation of the Financial Capital Maintenance (FCM) principle and the statutory purpose of limiting excessive profits. • The asset stranding revenue uplift should be removed if there is no optimisation of the RAB (removal of stranded assets from the RAB). The uplift is simply a wealth transfer from end-users to Chorus.
Cost Allocation IM	• Clarify that shared assets should not be allocated to FFLAS on an ACAM basis but should be shared across products. • Undertake work on how to remove Chorus' double recovery from both copper and fibre.
Capex IM	• Tighten the draft Capex IM requirements to further mitigate against the risk of over-investment and/or Chorus making inefficient investment decisions, including: – Widening the assessment factors to include effectiveness of Chorus' consultation; – Require the Commission to consult on individual capex proposals (and "individual capex design proposals") on the same basis as base and connection capex proposals; – Require all individual capex proposals to be consulted on rather than limiting according to the (potentially contentious) threshold - that the consultation is for the long-term benefit of end-users; – Ensure the minimum information disclosure requirements reflect all of the assessment factors. – Ensure the minimum information disclosure requirements include (quantified) evidence the capex proposals are *net beneficial for end-users,* are *superior to reasonable alternatives*, including non-capex options, and the analysis is subject to sensitivity analysis. – Ensure the Commission's evaluation of capex proposals includes testing the reasonableness of key assumptions (consistent with Part 4), such as by considering the method and information used to develop them; how they were applied; and their effect on the proposed base capex allowances; – Ensure the Integrated Fibre Plan requirements more closely replicate the Integrated Transmission Plan requirements; and – Address treatment of confidential information (as per Part 4).

Input Methodology	Change(s) required

Quality IM	• Ensure all Customer Service metrics are made mandatory, not optional.
	• Insert a new: “Changes to terms and conditions” metric within the Customer Service dimension to ensure a reasonable process for changes to service quality terms (including service descriptions, general and operational terms), and ensure regulatory oversight of these important changes.
	• Require detailed and regular reporting to support information disclosure obligations, including:
	  − Making disclosure of wholesale service agreement reference offers mandatory (which is consistent with the current UFB requirements).
	  − Require reporting on changes to terms and conditions (under the new metric).
	  − Require a broader and more detailed customer satisfaction survey with a terms of reference developed independently by the Commission (with access seeker and wholesaler input). This should include both end-user and access seeker satisfaction measures.

The following sections of this submission provide more detail on each of these change proposals.

Next steps

As we have previously indicated, timing and resource issues mean that a cross-submission deadline of 12 February is not feasible for 2degrees. We welcome the Commission’s commitment to review the length of the cross-submission period after submissions have been received and reiterate the time-period for cross-submissions should be extended.

2 Introduction

2degrees welcomes the invitation to submit in relation to the Commerce Commission's (the Commission's) "Fibre input methodologies: Draft decision - reasons paper" (draft Reasons Paper) and draft fibre Input Methodologies (IMs) under Part 6 of the Telecommunications Act (the Act).

As a full-service telecommunications provider, under the new regulatory framework 2degrees will purchase Fibre Fixed Line Access Services (FFLAS) for both UFB services - as we grow our fixed line business - and as key fibre input services to fixed and wireless networks. This will include inputs for Fixed Wireless Access (FWA) services and 5G mobile services in the form of Dark Fibre Access Services (DFAS) and Intra Candidate Backhaul Services (ICABS).[2] 2degrees is currently planning substantial future investments in a 5G network upgrade as 5G spectrum becomes available. As networks densify the costs and access terms of backhaul are expected to become increasingly important to the costs of network deployment, and ultimately the associated competitiveness of consumer services.

The Commission's 2019 Mobile Market Study report highlighted that "competitive conditions at the wholesale level have been improving in recent years", and this was "in large part due to 2degrees".[3] We reiterate that the Commission's implementation of the new Part 6 fibre regulatory framework has the potential to undermine this competition if not considered appropriately. It will be important to ensure the new Part 6 regulatory framework, which is heavily focussed on regulation of Chorus wholesale fibre inputs, does not harm potential competition from competitive wireless alternatives (for example by favouring particular technologies or access services such as retail fixed broadband services) or harm the competition that has emerged from 2degrees in the wireless market. To do so is inconsistent with the purpose of the Act, which is to promote competition for the long-term benefit of *all* telecommunications end-users (not just consumers of retail fixed UFB services).

The 2022 deadline appears to be driving an overly generous approach to Chorus

As a general comment about the Commission's draft Reasons Paper, in a substantive amount of areas where the Commission's positions are in conflict with the (near consensus) views of end-user representatives and Retail Service Providers (RSPs), the Commission has opted for a less prescriptive approach that will be easier to implement within the statutory timeframe afforded to the Commission. For example, the draft IMs adopt a non-prescriptive approach to:

- The cost allocation rules both for financial separation purposes and determination of financial losses (if any);
- Related Party Transactions (both in relation to provision of assets and services); and
- The type of information and evidence (including potential Investment Tests) Chorus will be required to provide to demonstrate proposed capex is justified/should be approved.

The non-prescriptive approach the Commission is proposing is highlighted by comparison between the Capex IM that is in place under Part 4 of the Commerce Act for Transpower and that proposed for Chorus e.g. the Commission has proposed no prescribed Investment Test and a 16-page long IM while the Transpower Capex IM is 101 pages.

[2] Alongside fibre input services, 2degrees will also purchase copper ADSL and VDSL services outside the new Part 6 of the Act for customers not able to receive fibre services.
[3] Commerce Commission, Mobile Market Study – Findings, 26 September 2019.

While part of this change in approach may reflect a change in philosophy, the differences go beyond prescription versus principle, with the fibre IMs simply silent on a number of critical elements which are addressed in the Part 4 IMs. For example, the Chorus Capex IM doesn't explicitly require Chorus to undertake an Investment Test, sensitivity analysis or comparison of its capex proposal against alternative options.

There are also other matters the Commission is silent on - such as the potential adoption of incentive mechanisms (e.g. an Incremental Rolling Incentive Scheme) that are in place under Part 4. 2degrees supports the Commission focusing on accurately determining Chorus' cost allowance (to ensure against excessive profits) and service quality limits for the first regulatory period. However, the Commission should clarify its intention regarding these matters, for example, will it consider incentive mechanisms for the second regulatory period?

We consider this less prescriptive, and less detailed, approach the Commission is proposing will favour Chorus. Particularly for the first regulatory period, where the Commission does not have the same level of historical information as it did for Part 4 and there is no proposed independent verification process. The Commission should not rely on Chorus being incentivised to make decisions for the benefit of end-users.

While we appreciate that the 'hard' January 2022 deadline of Part 6 of the Act has placed time pressure on the Commission to implement the fibre regulatory regime – which is why we did not support the adoption of such a 'hard' limit deviating from Part 4 of the Commerce Act at the Bill stage[4] – the Commission should be careful to ensure it doesn't result in poorer outcomes which generally favour the incumbent.

As outlined in section 4, there are a number of other issues where the Commission's proposals favour Chorus. These include cost allocation positions, calculation of financial losses and double recovery. The Commission needs to address these issues to meet the purpose of the Act.

Process issues

Related to the above, we know the Commission is subject to statutory deadlines for completion of this work. However, as the Commission is aware, 2degrees and other industry stakeholders are concerned the Commission's consultation period for the draft IMs is insufficient given the substantial length and detail of the material for review, and the decision to release this material for consultation together as an omnibus consultation.

While we have the benefit of external support with experience in Part 4, with less than 20 working days to respond to the IM[5] the limited timeframe has significantly curtailed the depth and breadth to which we have been able to review the consultation material, including the proposed drafting of the IMs.

The same issue is expected to arise with the cross-submission round if the Commission does not extend the timeframe from the currently proposed 10 working days, including due to staff resourcing over this period. We welcome the Commission's commitment to review the length of the cross-submission period after submissions have been received and reiterate the time-period for cross-submissions should be extended.

[4] Part 4 does not specify a 'hard' deadline for implementation of IM, ID and initial PQR requirements.
[5] The draft IMs and Reasons Paper consist of 668 pages of material (with the inclusion of expert reports etc adding a further 149 pages of material), excluding the WACC calculations spreadsheet. We note it is also relevant to compare the proposed Part 6 IMs with the Part 4 IMs, as these provide relevant precedent.

3 Areas we are generally comfortable with the Commission draft decisions

2degrees' previous submissions on the regulatory framework and the emerging views paper detailed many areas where we are in general agreement with the Commission and where the Commission's views align with all or the majority of end-users and RSPs.

We consider, for example, the Commission's overall legal interpretation (definition of financial losses aside) and decision-making framework are fundamentally sound. We also consider the Commission is on sound grounds to adopt the Part 4 WACC IM approach[6], a mid-point WACC, tighter cost allocation rules for financial separation, and the quality dimensions that will form the basis of quality regulation.

2degrees supports the Commission in relation to the following specific matters:

- **Framework:**
  - **Economic principles are a 'means' to an 'ends':** The Commission has articulated well the appropriate role for decision-making criteria, or economic principles, and how they fit with the statutory objective. We agree economic principles can help the Commission "make and explain" its decisions and, if applied consistently and coherently, "provide predictability to stakeholders". We also agree economic principles aren't outcomes the Authority should "give effect to for their own sake". Rather they are "subordinate to the Act's purpose" and a 'means' to helping the Commission "give effect to the purposes in s 166(2)".[7]
  - **Expansion of the economic framework to help guide the Commission's decisions, inclusion of "Incentive framework" and "competition screening questions" components.** The incentive framework makes explicit the framework the Commission already applies under Part 4 Commerce Act. The competition screening questions are appropriate given promotion of competition is an explicit part of the Part 6 objective statements**.**
- **FFLAS include ICABS:**
  2degrees welcomes the Commission's explicit clarification to stakeholders that "input services such as … ICABS … are FFLAS"[8] and the Departmental Report to the Select Committee had "clearly stated that this was the policy intent".[9] This should be considered a given, but Chorus has repeatedly claimed FFLAS does not include ICABS.
- **A single asset valuation IM for all LFCs:**
  2degrees agrees that "the benefits of having a standard IM covering all entities outweigh the potential burden faced by the smaller LFCs".[10]

[6] We have not been able to review the Commission's views on asset beta given time constraints.
[7] Commerce Commission, Fibre Input Methodologies (IM): Draft decision - reasons paper, 19 November 2019, paragraphs 2.157 and 2.158.
[8] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 2.136.
[9] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 2.62.
[10] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.47.

- **Capital contributions deductions:**

  2degrees agrees "Capital contributions must be deducted from asset values, as required by s 177(1)(a)(i) of the Act".[11]

- **Adjustment to the RAB following deregulation:**

  - 2degrees agrees with removal of assets from the RAB following deregulation (along with related financial losses and the value of shared assets attributable to the deregulated component of regulated FFLAS).[12]

  - We also support the Commission's "draft decision … to reduce the value of the financial loss asset commensurate with the percentage reduction in the aggregate original UFB asset value remaining in the main RAB at the time of deregulation".[13]

- **WACC Determination:**
  - 2degrees agrees with the adoption of an approach to WACC which closely follows the Part 4 WACC IMs. This is also consistent with the approach the Commission took in the TSLRIC price determination for Chorus' copper network access services.

  - 2degrees agrees the risk-free rate should match the length of the regulatory period and supports use of "a three-year risk-free rate initially, followed by a three- to five-year risk-free rate, dependent on the length of future regulatory periods".[14]

  - 2degrees agrees the WACC percentile should be set at mid-point. Chorus has not provided any credible or sound evidence that would justify a reconsideration of the Commission's position on this matter. We also agree "there is no case for a WACC uplift in the pre-implementation period".[15]

  - **2degrees agrees "relying on quality regulation to mitigate the risk of under-investment (supported by the rules set in the Chorus capex IM) is a more targeted tool** that can specifically address the expectations of end-users for the level of quality to be provided by regulated providers. In contrast, there is no guarantee that regulated providers will choose to invest in higher network quality if an uplift to the regulatory WACC was allowed."[16]

- **Cost allocation:**
  - 2degrees support adopting narrower cost allocation rules for financial separation of Chorus' fibre business from other regulated and non-regulated activities. We also support only providing for an accounting-based allocation approach (ABAA) for financial separation purposes (as distinct from determination of financial losses), and exclusion of the Avoidable Cost Allocation Methodology (ACAM) and optional variation to accounting-based allocation approach (OVABAA) methodology.[17]

[11] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.75.
[12] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.263.
[13] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.277.
[14] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, page 212.
[15] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 5.129.
[16] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.1467.2.
[17] We note that even if it is appropriate to exclude ACAM and OVABAA for financial separation purposes, this does not provide relevant precedent or reason for rejecting their use for the entirely separate function of determining financial losses.

- While we do not support the adoption of a non-prescriptive approach to cost allocation, we support the proposal "that the regulated providers must provide explanations for the choice of proxy allocators for allocations between regulated FFLAS and other services that are not regulated FFLAS".[18] This requirement should be fleshed out to require Chorus to undertake sensitivity analysis on the impact of different proxy allocators. The Commission will need this type of information in order to "review regulated providers' choice of allocators" and "the level of cost allocated to regulated FFLAS relative to that which would have been allocated using other allocators".[19] Inevitably, the key driver for Chorus will be which allocators provide the best (highest) price/profit outcomes.

- 2degrees supports exclusion of certain expenses from operating expenditure including "Court or other statutorily imposed penalties … that a regulated provider incurs in providing the regulated FFLAS".[20]

- **Capex IM:**
  - 2degrees supports the Commission's use of "… the Transpower capex IM as a starting point for the Chorus capex IM"[21] and the proposal to adopt: "… an ex-ante propose and approve style approach to assessing and approving Chorus' capex projects and programmes".[22]

  - 2degrees supports the approach of dividing capex into Base Capex (as per Transpower), Individual Capex (for larger capex as per Transpower Major Capex) and Connection Capex (new). We also support the Commission's proposal to treat Connection Capex as a mix of Base Capex plus variable Capex, with the latter reflecting "the balance of connections between the baseline component forecast and the total number of actual connections for each year over the regulatory period".[23] The ex-post compensation arrangements should ensure the variable Connection Capex allowance does not under or over-compensate Chorus for actual connections growth.

  - 2degrees supports the Commission's proposal "that the Chorus capex IM will require the regulated providers subject to PQ to set out the quality impacts of any capex proposal."[24]

- **Quality:**
  - 2degrees supports the conceptual framework of adopting a Quality Dimensions IM which includes seven quality dimensions: Six fibre lifecycle dimensions (ordering, provisioning, switching, faults, availability and performance) PLUS an overarching customer service dimension. (Although, as we set out in section 10, we question the proposed split between mandatory and optional service quality dimensions and at a minimum, additional customer services metrics and information reporting is required.)

[18] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.375.
[19] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.429.
[20] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.578.
[21] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.1583.
[22] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph X.61.
[23] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.1591.1.2.
[24] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.1470.

- Relatedly, we also agree that “the quality dimensions and level of prescription” should “take into account that some regulated FFLAS are likely to be used as inputs for telecommunications services that compete with regulated FFLAS-based services at the retail level and that access seekers active in these markets might have specific quality requirements that may be different from those of end-users”.[25]

- We support the Commission erring on the side of more rather than less service quality measures and agree with the Commission that “Given the change in the regulatory environment we consider it is important we set out more, rather than fewer, quality dimensions in the IM. Our view is that as industry agreements fall away, it is important to have safeguards in place to protect the interests of end-users (in line with the requirement in s 162 to promote outcomes consistent with those in workably competitive markets) if certain quality dimensions give us cause for concern”.[26]

[25] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.1450.
[26] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.1514.

4 Risk Chorus won't be "limited in their ability to extract excessive profits"

2degrees is concerned there is a significant and material risk Chorus won't be "limited in their ability to extract excessive profits". There are a number of elements of the Commission's Emerging Views and draft Reasons Paper which potentially increase the risk the IMs and first PQR determination will fail to adequately limit Chorus' ability to extract excessive profits as required by section 162(d). We consider that a number of the draft decisions could result in regulated fibre prices which include 'generosities'.

The elements we are most concerned about at this stage include:

- **Granting Chorus what appears to be an excess amount of discretion:**

  We agree with the Commission that "In the absence of regulatory rules, regulated providers have incentives to increase the allocation of shared costs to regulated FFLAS, and recover the revenue relating to these costs following implementation".[27] We also agree "the cost allocation IM has a role in mitigating the incentives that regulated providers might have to recover a disproportionate share of any shared network costs from FFLAS end-users (and thus, increase prices for FFLAS)".[28]

  However, we do not consider reliance on non-prescriptive cost allocation rules etc will provide the necessary safeguards to prevent Chorus from exploiting opportunities to artificially inflate its regulated FFLAS business costs.

  We note the IMs do not currently address Related Party Transactions in relation to provision of goods and services. This matter was an area of particular focus during the statutory review of the Part 4 IMs given the potential for Related Party Transactions to inflate regulated businesses' costs.

  Chorus has suggested "there is nothing different in Chorus' incentives relative to other suppliers that engage in both regulated and unregulated services (of which there are several airports that are the most obvious example)".[29] However, we note there has been a history of attempting to inflate costs in the telecommunications market, for example in relation to TSO and copper TSLRIC cost estimation.

  Greater regulatory prescription and/or oversight is required.

- **The Commission proposes to limit allocation of shared assets to no higher than that under ACAM:**

  The Commission has stated in relation to the "Limits on allocation of shared assets to regulated FFLAS" that "The shared costs allocated to regulated FFLAS should be no higher than the unavoidable costs that would arise in a scenario where the services that are not regulated FFLAS are not provided".[30] We don't believe it is the intention of the

[27] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.174.
[28] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 2.200.2.
[29] Chorus, Cross-submission in response to the Commerce Commission's fibre regulation emerging views, 31 July 2019, paragraph 63.
[30] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.72.

Commission, but this statement is the same as saying the cost allocation is capped as the stand-alone cost of a regulated FFLAS business. This is no "limit" as it is the highest conceivable cost allocation that could be permitted and ACAM is supposed to be excluded.

- **Financial losses need to be determined on an incremental cost basis and exclude shared and common costs:**

  The Commission's draft decision to allow Chorus to include the capitalised value of financial losses PLUS a contribution to common costs (financial losses+) in the RAB, rather than the capitalised value of financial losses only (if any) will allow Chorus to capitalise excessive profits. This is inconsistent with any reasonable or orthodox interpretation of "financial loss" and is inconsistent with the statutory objective to limit excessive profits, and must be amended to be calculated on an incremental cost basis.

- **Failure to address double recovery between copper and fibre will result in windfall gains to Chorus:**

  The Commission continues to assert "… it would be impractical to fully ensure that there is no double or under-recovery regarding UFB initiative past losses and the FPP for the UCLL and UBA services".[31] The Commission's commentary on double recovery relates to historic double recovery and double recovery between Part 4 Commerce Act services (not applicable to Chorus) and Part 6 Telecommunications Services, but doesn't address the matter of double-recovery from both copper and fibre services which will continue while copper services remain in service. We note submissions from Spark and Vocus have provided illustration of how double recovery could be addressed and consider that the Commission should explore this further.

- **There should be no asset stranding uplift without optimisation of the RAB:**

  The Commission is proposing a revenue uplift to compensate Chorus for asset stranding risk, but with no mechanism for removal of stranded assets from the RAB (with assets instead only removed if they are deregulated).[32]This is simply be a wealth transfer from end-users to Chorus. 2degrees considers that the Commission should remove the asset stranding uplift.

- **The transition 'mechanisms' heighten the risk of poor outcomes for end-users:**

  Out of necessity the Commission is adopting 'transition' mechanisms to meet the Telecommunications Act deadlines for implementation of the new fibre regulatory regime.[33] This includes, for example, not providing for an Independent Verification process for the first PQR determination.

  The Commission should adopt 'safe-guard' mechanisms to protect against the risk that the limited timeframes for implementing the new fibre regulatory regime work in Chorus' favour at the expense of the long-term interests of end-users. We discuss this further in the following section.

[31] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.528.
[32] It appears that the Commission may have conflated removal of assets due to deregulation with removal of assets due to asset stranding.
[33] See discussion in the next section.

5 The need to adopt 'safe-guard' mechanisms

As set out above, 2degrees remains concerned by the Commission's proposed 'transitional' arrangements for introduction of the new regime, including that the Commission "… do[es] not consider that there is sufficient time for Chorus and the Commission to set up an independent verification process for the first regulatory period."[34]

The lack of oversight in the transition phase reinforces the concerns 2degrees and others have raised that information asymmetries and limited oversight of Chorus given time pressures will work in Chorus' favour, particularly given the "immaturity of the new fibre regulatory framework (for example, the Commission doesn't have the history of Asset Management Plan (AMP) capex and opex forecasts that it has in electricity)".[35]

The Commission has suggested "the repeated nature of regulation allows us to observe through ID expenditure outturns over time, which lessens the incentive, and therefore risk, of regulated providers gaming the expenditure forecasts".[36] However, this discipline hasn't been evident historically and is likely to be weakest where there is no historical data i.e. during the implementation of the new fibre regulatory regime and the first PQR determination.

As highlighted by our earlier submissions we consider Independent Verification is an important regulatory safeguard. Independent Verification is particularly critical given the inflation of cost estimates that has taken place in the past e.g. in relation to the TSO and copper TSLRIC modelling. Notably, if this strategy is adopted in the fibre regulatory regime, the Commission will not be able to safely rely on Chorus' supplier or capex proposals in the same way it has under Part 4 Commerce Act.

If the Commission considers Independent Verification cannot be undertaken for the first regulatory period, we propose at a minimum:

- The Commission should undertake its own review, which it has reserved its right to do: "We reserve the right to seek our own external expert opinion of Chorus' base capex proposal for the first regulatory period";[37] and/or
- The Commission could consider a more abbreviated/focussed independent verification e.g. looking at a sample of Chorus' cost forecasts; and/or
- The Commission could adopt more permissive re-opener provisions compared to those that apply under Part 4 of the Commerce Act to mitigate against false or misleading information being knowingly provided. As we stated previously: "If the Commission relies on Chorus' supplier proposal, as part of the price-quality determination, it should consider adopting a 're-opener' that would allow the price-quality path to be adjusted if Chorus' actual capex and/or opex is below the levels in its proposals and allowed for in the price path. This could act as a proxy for the type of rules the Commission applies to scrutinise Electricity Distribution Businesses' (EDBs') past forecast performance".[38]

[34] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.1839.
[35] 2degrees, Submission on Commerce Commission Fibre Regulation Emerging Views Paper, 16 July 2019.
[36] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 2.204.1.
[37] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.1839.
[38] 2degrees, Submission on Commerce Commission Fibre Regulation Emerging Views Paper, 16 July 2019.

6 Determination of financial losses needs to be on an incremental cost basis

The Commission is directed by section 177(2) of the Act to calculate the "financial losses" of Chorus' UFB business (if any). 2degrees does not consider that the Commission has discretion to adopt any alternative than to calculate financial losses on an incremental cost basis. The starting point must be for the Commission to define what is meant by "financial loss". Deviation from an incremental or avoidable cost allocation methodology would be in violation of any reasonable or orthodox definition of "financial losses" and would result in Chorus being overcompensated in violation of the Commission's Financial Capital Maintenance (FCM) principle and the statutory purpose of limiting excessive profits.

The Act also provides clear direction, "To avoid doubt" that the costs included are "as a direct result of meeting specific requirements of the UFB initiative" (section 177(5)). The Commission should consider what is meant by a "direct" cost but it should be clear that this does not include costs that Chorus would have incurred anyway e.g. costs incurred prior to the establishment of the UFB agreement, and shared and common costs. This provides clear legislative direction that financial losses should be calculated on an incremental cost basis.

While the Commission alluded to the definition of financial loss being on an avoidable or incremental cost basis when it stated: "In a workably competitive market, a firm employing an asset (such as a duct) to supply one service (DSL) may use that asset to supply a second service (regulated FFLAS) if it is able to recover through revenues from the sale of the second service at least the directly attributable costs of that service",[39] it is deviating from this in its draft proposal to adopt an ABAA cost allocation approach.

2degrees submitted extensively on how to calculate financial losses in response to the Emerging Views consultation. This included addressing each of the arguments the Commission relied on to reject an incremental cost approach and instead adopt an ABAA cost allocation approach. The clear conclusion reached was that rejection of an incremental cost approach to calculating financial losses was not justified by the Commission's Emerging Views reasoning.

It is disappointing that the Commission has not addressed this in its draft Reasons Paper. In the absence of any explanation why the Commission rejected or did not have regard to our views on financial losses, our reasons for disputing the Commission's position still stand.

Commission (re-used rationale)	2degrees' comments[40]
"It is consistent with the draft decision on cost allocation of assets for the initial RAB …"[41]	Not a reason to adopt ABAA. "This is not a relevant consideration. The calculation of financial losses from UFB and development of the building blocks (including RAB) for Chorus' FFLAS business are separate exercises. The reasons the Commission has provided for why it (i) limited

[39] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.336.
[40] 2degrees, Submission on Commerce Commission Fibre Regulation Emerging Views Paper, 16 July 2019.
[41] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.479.1.

Commission (re-used rationale)	2degrees' comments[40]
	the role of ACAM under Part 4 Commerce Act (previously a mandatory method); and (ii) rejected ACAM for cost allocation purposes for FFLAS are not applicable to a consideration of how to calculate financial losses, nor do they justify artificial inflation of the financial losses. The Commission's arguments are based on treating the regulated business on a stand-alone cost basis and over-allocating costs to the regulated business. Application of ACAM to calculate financial losses would treat the UFB business as the incremental basis and avoid over-allocation of costs." [footnote removed] Further, we do not agree with Chorus that "Assertions from mobile network operators that our initial asset valuation (initial RAB) should include only the incremental cost of fibre build is analogous to claiming that the cost of termination on their networks should only take into account the incremental cost of the 4G Radio Access Network".[42] This confuses the role of cost allocation for financial separation purposes with cost allocation for the purpose of determining financial losses. As Chorus later pointed out, when it argued an incremental cost approach be taken in relation to new services: "In a competitive market, a firm will choose to undertake that second activity if it is able to recover anything more than the incremental cost of operating in that second market".[43] We have previously noted "Chorus' defence of the OVABAA methodology appears to provide (unintended) support for adopting an incremental cost approach to financial losses". Chorus' argument was that application of ABAA could make an efficient and profitable business "uncommercial and unprofitable" and it does this because "under ABAA, the costs that would be allocated … could exceed incremental cost because this is an accounting method, rather than an economic allocation".[44]
"It has a transitional and proportional effect (due to dynamic allocation) for shared costs that reflect that in 2011, UFB was incremental, new investment, but by implementation date will be	The relevant commentary in this statement is acknowledgement that UFB was an "incremental … investment". Whether or not the UFB is now a core, ongoing business is not relevant to what cost allocation methodology should be applied.

[42] Chorus, Cross-submission in response to the Commerce Commission's fibre regulation emerging views, 31 July 2019, paragraph 7.
[43] Chorus, Cross-submission in response to the Commerce Commission's fibre regulation emerging views, 31 July 2019, paragraph 65.
[44] Chorus, Submission in response to the Commerce Commission's fibre regulation emerging views dated 21 May 2019, 16 July 2019, para 104.

Commission (re-used rationale)	2degrees' comments[40]
the core, ongoing business …"[45]	
"It can apply to both Chorus and the other regulated providers."[46]	An avoidable or incremental cost methodology (or any other methodology) can equally apply to both Chorus and LFCS.
"It is robust for use of fibre technology for non-UFB purposes including UFB initiative assets being used to provide services that are not regulated FFLAS and vice versa."[47]	"2degrees does not agree with this statement. The ABAA method would result in an artificial increase in the calculated financial losses about the actual financial losses (if any) Chorus incurred. An incremental or avoidable cost methodology is the only economically sound approach for calculating financial losses."
"It is consistent with the economic principle of FCM, including in terms of ensuring that Chorus receives a normal return on its investment in reused and common copper assets, particularly during the later years of the loss period when some of the assets will be increasingly, if not fully, used to provide UFB services."[48]	2degrees disagrees with this statement. An ABAA approach would result in over-compensation. An incremental or avoidable cost approach is consistent with the economic principle of FCM as it would allow full recovery of financial losses. As we stated previously, "For the Commission to rely on arguments that the use of ABAA for calculating financial losses "is consistent with the economic principle of FCM" it would need to demonstrate financial losses calculated on alternative incremental or avoidable cost basis would prevent Chorus from being fully compensated for past losses and earning at least a normal return. 2degrees cannot see a basis on which the Commission will be able to do so."
"… due to the level of asset sharing in a telecommunications network [an incremental cost approach] could preclude a material number of assets and operating costs from being considered in the financial loss asset calculation for Chorus in particular."[49]	"The Commission's statement that an incremental or avoidable cost methodology "would effectively remove many of the assets used to provide FFLAS" does not provide a rationale for inclusion or exclusion of common or shared costs. Businesses entering into new markets do not consider overhead cost allocations when developing new products and services but seek to ensure that the expected net present value of the business proposal is positive.[50]" [footnote removed]

[45] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.479.2.
[46] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.479.3.
[47] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.479.4.
[48] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.479.5.
[49] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.481.
[50] See: Unison, Unison Submission on amended draft decision to remove ACAM as a cost allocation option form the Input Methodologies, 13 October 2016, page 2.

The Commission has stated "We do not agree with the access seekers' proposal to determine past losses incurred in supplying UFB initiative services based on their incremental costs. Such an approach would load all shared costs onto the existing copper-based services, which are gradually being displaced by FFLAS."[51] We consider the Commission is confusing the calculation of financial losses, which is a backward-looking exercise at a point in time, with cost allocation for financial separation purposes (a forward looking cost allocation, where we agree shared costs will be distributed across both fibre and copper-based services). For the purposes of calculating the financial losses, the replacement of copper by fibre over time is irrelevant (although to the extent it occurs pre-Implementation Date (2022) it reduces the size of financial losses (to the extent there are any).

The other new argument the Commission has provided appears to be that "our earlier reasoning for having a cap on costs allocated to regulated FFLAS based on unavoidable costs applies to the calculation of the past financial loss asset. This reflects that the relevant issues around sharing and repurposed assets apply both before and after the implementation date."[52] This statement simply seems to mean that the cost allocation for the purposes of financial losses should be capped at the stand-alone cost of the UFB business i.e. no higher than an ACAM cost allocation. We do not think this is what the Commission intended. We also do not consider this is consistent with section 177(5) which provides that "To avoid doubt, the initial value of a fibre asset determined under this section includes the costs incurred by the provider in relation to the asset— … as a direct result of meeting specific requirements of the UFB initiative."

Other relevant considerations

2degrees considers that the following additional points are also relevant to adoption of an incremental cost approach to calculation of financial losses:

- The Commission's view, in relation to cost allocation for financial separation purposes, is that end-users should share the benefits of efficiency gains in the supply of FFLAS, including through lower prices: "By allocating a proportion of shared costs to services that are not regulated FFLAS, the cost associated with the supply of regulated FFLAS will be lower, and end-users of regulated FFLAS will share the benefits".[53]

  This recognises that use of ABAA (instead of ACAM with the regulated business treated as the stand-alone business) for financial separation purposes results in a lower allocation of shared costs to the regulated services and provides end-users with the benefit of lower prices. This same argument applies in favour of using an incremental cost approach (ACAM with the regulated business treated as the avoidable business), and this will result in a lower allocation of common costs and lower prices for end-users.

- We understand the High Court Part 4 IMs decision also provides relevant precedent in relation to its concerns that "The more common costs that are allocated to regulated services, the higher the prices for regulated services will be"[54] and "An initial RAB value would … be fundamentally flawed … if it failed to limit suppliers' ability to extract

[51] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.485.
[52] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.488.
[53] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.354.1.
[54] WELLINGTON INTERNATIONAL AIRPORT LTD & ORS v COMMERCE COMMISSION [2013] NZHC [11 December 2013], from paragraph [1804].

excessive profits over time".[55,56] These statements apply equally to treatment of the regulated business (be it electricity distribution or fibre) as the stand-alone business under ACAM, and for any treatment of the regulated business as the 'incremental' business for the purpose of determining financial losses.

- Chorus has said that "The Act requires the Commission to include in the calculation pre and post-2011 fibre assets, shared assets between fibre and copper services and calculate accumulated unrecovered returns, adjusted to reflect the present value".[57] Chorus doesn't attempt to substantiate its claim. We are not clear where the Act mentions shared costs or pre-2011 costs, let alone requires these to be included in the calculation of financial losses. The relevant direction is provided by section 177(5) which would appear to exclude these costs as they are not "as a direct result of meeting specific requirements of the UFB initiative".

- Finally, we note the Commission has been entirely silent on its interpretation of section 177(4): "It is not the intention of subsections (2) and (3) that regulated fibre service providers should be protected from all risk of not fully recovering those financial losses through prices over time", including how this has impacted (if at all) the way the Commission proposes to determine and allow Chorus' to recover financial losses (if any). We would welcome clarity on this matter.

[55] WELLINGTON INTERNATIONAL AIRPORT LTD & ORS v COMMERCE COMMISSION [2013] NZHC [11 December 2013], paragraph [770].
[56] While the High Court supported the Commission's views against ACAM for financial separation purposes (where the regulated business would be treated as the stand-alone business), the same analysis would support ACAM for calculating financial losses with the UFB business treated as the avoidable business.
[57] Chorus, Cross-submission in response to the Commerce Commission's fibre regulation emerging views, 31 July 2019, paragraph 9.6.

7 Missing asset stranding provisions

2degrees does not support the ex-ante allowance for asset stranding risk. This is effectively the same as providing Chorus with a WACC uplift and will result in higher prices for access seekers and end-users.

In order for the higher upfront prices to potentially be beneficial for consumers there would need to be a mechanism for removal of stranded assets from the RAB. This does not appear to be the case.

While the Commission recognises:

- "Our draft decision is to clearly allocate some of this risk to regulated fibre providers as they are best placed to manage it"; and
- "… any additional revenue is provided only if there is an expectation that there will be an equivalent reduction in revenue at some point in the future. …"[58] and
- This "requires a process and ability to identify and exclude stranded assets from the RAB depending on the extent of asset stranding risk being compensated for".[59]

we cannot see any such provisions in the proposed IMs or proposed RAB IM.

It appears the only provision the Commission has provided is for removal of assets due to deregulation. However, deregulation only means an asset is subject to competition, it does not mean an asset is stranded or that Chorus won't be able to recover its cost.

There is no reasonable justification for providing Chorus compensation for the prospect that some of its monopoly assets may be subject to competition in the future. This is inconsistent with outcomes in workably competitive markets. We note and agree with the Commission's following statement:[60]

> Deregulation does not, by itself, strand assets. Competition does not necessarily preclude earning revenue and a normal return, and as Link Economics report noted;[636] these are partially subsidised assets which may earn a greater than normal return when not subject to regulation.

The way the draft IMs are currently prescribed, end-users would pay higher prices now but stranded assets would remain in the RAB so end-users would pay higher prices in the future as well. End-users wouldn't face the trade-off between 'a bird in the hand, versus two in the bush' as the mechanism would simply result in higher prices both in the short and long-term. This is not in the interest of end-users and would simply be a wealth transfer from end-users to Chorus.

The Commission should only consider adopting an ex ante compensation mechanism for asset stranding if it is introduced in conjunction with aa mechanism for removal of stranded assets (not just deregulated assets) from the RAB.

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[58] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.1330.
[59] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.1342.4.
[60] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.1364.

8 Chorus' consultation requirements

Consultation is an important part of the development of any supplier proposal and capex proposals. Chorus itself acknowledges "There is general agreement on a requirement for Chorus to consult on price-quality proposals on an enduring basis".[61]

The existing consultation requirements proposed by the Commission are lighter than consultation requirements that we understand it applies under Part 4 of the Commerce Act. For example, the Transpower Capex IM includes specific requirements for Transpower to consult before submitting capex proposals to the Commission which the Commission should draw on. We do not consider that there are any industry or legislative-specific differences to justify a different approach for the Chorus Capex IM.

The rationale the Commission has provided for not requiring Chorus to consult on its capex proposals is not compelling:

- The Commission has argued "the Chorus capex IM is primarily focussed on matters relating to capex. Effective consultation may need to consider other aspects that affect capex including opex and quality".[62] This is simply an argument for requiring Chorus to consult on both supplier and Capex proposals, and not an argument against requiring any consultation at all. This argument could equally be made in relation to Transpower and is not industry or legislative specific.

- The other rationale the Commission has offered is that "there may be restrictions on consultation due to commercially sensitive information which may limit the effectiveness of consultation with access seekers and end-users".[63] This may impact on the nature and degree of any consultation, and who has access to the commercially sensitive information (the Commission has robust mechanisms in place for authorisation of access to commercially sensitive or confidential information), but again is not an argument against requiring any consultation at all.

While we consider Chorus should consult with its customers and other stakeholders, as a matter of good practice, the efficacy of any such consultation may be limited if Chorus does so unwillingly and/or doesn't recognise the value of consultation.

With the right culture and a customer-centric focus, Chorus will proactively engage and consult with its customers and other stakeholders regardless of what the Commission or the IMs require it to do. From 2degrees' perspective we want the consultation to be useful for both Chorus and its customers and other stakeholders.

We support use of a number of vehicles for engagement, including direct customer engagement, workshops, posting material on its website and formal consultations. Good consultation practices are something that can reasonably be expected to evolve and develop as Chorus gains more experience and learns from what worked well and what didn't, and

[61] Chorus, Cross-submission in response to the Commerce Commission's fibre regulation emerging views, 31 July 2019, paragraph 8.7.
[62] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.1736.1.
[63] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.1736.2.

from customer and stakeholder feedback on its processes. We don't expect any Chorus consultation to be 'perfect' first time round or to remain static.

Key principles for ensuring successful customer and stakeholder consultation (for both supplier and capex proposals) include:

- engaging with customers and stakeholders constructively and transparently;
- undertaking consultation on its proposals, or proposal development, with an open mind;
- being clear about where customers and stakeholders can influence Chorus' decisions or proposals; and
- recognising consultation is a two-way street. It isn't just an opportunity for Chorus to hear from stakeholders. It is also an opportunity for customers and stakeholders to get a better understanding of Chorus' thinking and why it is proposing what it is proposing.

To support and incentivise effective consultation we consider Chorus should be required to demonstrate:

- The extent to which and how its engagement and consultation with its customers and other stakeholders influenced/impacted on its proposals; and
- That its proposals support the objective to "supply fibre fixed line access services of a quality that reflects end-user demands" (s. 162(b) Telecommunications Act).

We consider these to be important "assessment factors" in consideration of any supplier or capex proposals.

We also note the importance of Chorus (and other LFCs) in effectively responding to customer (RSP)-led requests for new products and services. This is vital to support innovative, competitive retail products that successfully respond to evolving customer demands in a timely manner. It should not be assumed that LFCs will identify and lead all changes to their wholesale services that are to the benefit of end-users.

9 Capex IM requirements should be tightened

The Commission should tighten the draft Capex IM requirements to further mitigate against the risk of over-investment and/or Chorus making inefficient investment decisions.

The draft Chorus Capex IM is a particularly clear example where the Commission has chosen to substantially deviate from the approach taken in Part 4 Commerce Act. This is highlighted by the fact the draft Chorus Capex IM is just 16 pages, whereas the Transpower Capex IM is 101 pages.[64]

There are many areas where the differences are well explained and justified. For example, the Commission identified that it hasn't adopted the "identified programme mechanism" used in the Transpower Capex IM, explained what it is, and explained why it didn't consider it should be transposed to the Chorus Capex IM.[65]

A lot of the differences between the Transpower Capex IM and the draft Chorus Capex IM, however, are undocumented and unexplained. This has made it more difficult to submit on the draft Chorus Capex IM. It appears the differences aren't just in philosophical approach, with the Commission preferring a more principles-based approach than the comparatively prescriptive form of the Part 4 IMs. We consider there are critical where there are simply gaps or apparent omissions in the content of the drafts.

We consider that a number of elements of the Chorus Capex IM should be reassessed. None would require substantive redrafting to rectify or to provide a materially better draft of the IM. We summarise these in the following table:

Change Required	Explanation
Assessment factors should be widened to include effectiveness of Chorus' consultation:	A material improvement would be to require Chorus to provide details of "the extent of consultation by Chorus with its access seekers and end-users" (clauses 3.6.8(1)(j) and 3.6.14(j)) should be broadened to include: (i) how the consultation impacted on its proposals; (ii) evidence of the extent to which Chorus has developed an understanding of its customers want in terms of service and future investment; and (iii) publication of submissions and Summary and Response reports).
All individual capex proposals should be consulted on	We oppose inclusion of a threshold test that "The Commission may consult on the individual capex proposal if satisfied that the consultation is for the long-term benefit of end-users". This will inevitably result in needless arguments about whether consultation "is for the long-term benefit of end-users" (clause 3.6.27(3)). We consider the answer is yes, in all instances.

[64] https://comcom.govt.nz/__data/assets/pdf_file/0026/88280/Consolidated-Transpower-capital-expenditure-input-methodology-determination-as-at-1-June-2018.PDF.

[65] Time constraints mean we have not reviewed and documented all the potential differences which may not be justified. The examples in the table below are intended to be illustrative only. We consider it would be prudent for the Commission to undertake a clause-by-clause evaluation of the Transpower Capex IM to provide surety there is sound justification for exclusion on all elements of the Transpower Capex IM that have not been transposed. The above highlights that the draft Chorus Capex IM should move closer to the Transpower Capex IM.

Change Required	Explanation
The Capex IM should require the Commission to consult on individual capex proposals on the same basis as base and connection capex	The Transpower Capex IM requires the Commission publish and consult on both base and major capex proposals.[66] We don't see any industry specific reason for adopting a different approach to the Chorus Capex IM and base and individual capex proposals. The proposed consultation requirements for base and connection capex (clause 3.7.4) should also apply for individual capex. Consultation on individual capex is particularly important as there won't be an equivalent opportunity to submit in relation to the PQR draft determination (which will include base and base connection capex, but not individual capex)
The Capex IM should require the Commission to consult on "individual capex design proposals"	The Commission should be required to consult on individual capex design proposals (clause 3.6.23). Again, no explanation has been provided why the Commission does not favour this approach.
The minimum information disclosure requirements should mirror the assessment factors:	2degrees considers the "Assessment factors" (clause 3.7.6) can be reasonably assumed to be valid in relation to all capex proposals. We consider the qualification "To the extent the Commission considers it relevant" (clause 3.7.6(1)) to be superfluous and should be deleted. More importantly, regardless of whether the Commission retains its more 'principles-based' approach, we consider that, at a minimum, Chorus should be required to provide material relevant to each of the "Assessment factors" when providing the Commission with any capex proposals (clauses 3.6.8(1), 3.6.14(1) and 3.6.25). We note the individual capex minimum information requirements (clause 3.6.25(1)(a)) makes limited reference to the "Assessment factors" stating "The information included in the individual capex proposal must be based on the information approved for the individual capex design proposal and may include…(a) enough information for the Commission to assess the individual capex proposal against the capital expenditure objective, having regard to the assessment factors" (emphasis added). This should be tightened to a mandatory requirement ("must" not "may") and should explicitly include a requirement that the information "includes, but isn't limited to, information in relation to each of the assessment factors.
The minimum information disclosure requirements should include quantified evidence the capex proposals	The minimum information requirements for individual capex proposals should include a requirement to include: (i) quantified investment test analysis that determines the expenditure is to the long-term benefit of end-users; and (ii) quantified assessment of the proposed investment against reasonable alternatives, including non-capex alternatives i.e. clause 3.6.25(c) should be strengthened. The evaluation criteria (clause 3.7.5) should also explicitly include that the capex proposal is

[66] Transpower Capital Expenditure Input Methodology Determination 2012 (Principal Determination), clause 8.1.1, 1 June 2018.

Change Required	Explanation
are net beneficial for end-users	(i) to the long-term benefit of end-users; and (ii) superior to reasonable alternatives, including non-capex options.
The Chorus Capex IM should include requirements for Chorus to provided quantified evidence that proposals have positive expected net benefits	The Transpower Capex IM provides relevant "investment tests" which are equally applicable for Chorus/fibre capex proposals and should be reflected in the Chorus Capex IM, including that the proposal: (i) "has a positive expected net … benefit", (ii) "is sufficiently robust under sensitivity analysis", (iii) "has the highest expected net … benefit [compared to alternatives]".[67] Likewise, the Transpower Capex IM requires Transpower to specifically quantify "competition effects"[68] which would seem directly relevant for the Chorus Capex IM. We also note the Transpower Capex IM requirements for major capex proposals include an "Explanation of the expected benefits of proposed expenditure and its impact on transmission charges",[69] which includes both "a description of the benefits" and "to the extent reasonably possible, a quantitative estimate of the benefits".[70] The Commission has stated "While we expect Chorus to undertake economic analysis to justify its capex investments, we expect there will be uncertainty and judgement required in the valuation of costs and benefits that would be required to apply a net market benefit test. At this stage, the Commission would still be required to exercise judgement in determining whether the investment test had been met".[71] This statement holds true for any form of economic analysis Chorus may apply. It also holds for any quantified Cost Benefit Analysis etc the Commission undertakes. The issue is not unique to Chorus or the Chorus Capex IM. Chorus should be required to quantify the net benefits of its proposals to the extent reasonably practicable. There is no basis for using existence of non-quantifiable benefits, uncertainty or need for subjective judgement as grounds for not requiring a quantified net benefit test.
The Commission's evaluation of capex proposals should include testing the reasonableness of key assumptions	The "General evaluation of base capex proposals" in the Transpower Capex IM includes that the Commission will consider "the reasonableness of the key assumptions relevant to base capex relied upon, including- (i) the method and information used to develop them; (ii) how they were applied; and (iii) their effect on the proposed base capex allowances". It is not apparent why this has not simply been transposed to the Chorus Capex IM.

[67] Transpower Capital Expenditure Input Methodology Determination 2012 (Principal Determination), 1 June 2018, Schedule D, clause D1.
[68] Transpower Capital Expenditure Input Methodology Determination 2012 (Principal Determination), 1 June 2018, Schedule D, clause D4(1)(k).
[69] Transpower Capital Expenditure Input Methodology Determination 2012 (Principal Determination), 1 June 2018, Subpart 5, Part 7.
[70] Transpower Capital Expenditure Input Methodology Determination 2012 (Principal Determination), 1 June 2018, Subpart 5, Part 7, clause 7.5.1(1)(a) and (b).
[71] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.1658.1.

Change Required	Explanation
The integrated fibre plan requirements should follow the Integrated Transmission Plan requirements more closely	The Commission has stated that "The requirements for the integrated fibre plan (IFP) in the draft IM are high-level rather than prescriptive, given the IM needs to be enduring".[72] However, we are unclear what in the Integrated Transmission Plan (ITP) requirements is not enduring, nor which are Transpower or legislative specific. We consider the ITP could simply be transposed.[73] While there are overlaps between the draft Chorus IFP requirements and Transpower ITP requirements (both include elements that are not included in the other),it appears there are elements of the ITP that should be transposed to the IFP, including Asset Management Plan requirements and specific forecasting requirements. The following highlighted forecasting requirements seem particularly relevant given the dynamic and uncertain nature of telecommunications: E2 **Information to be included in the ITP narrative** (1) with reference, where relevant, to the information contained in the **ITP supporting documents**, a high level- (a) overview of the expenditure and outputs which are proposed for the first **regulatory period** to which the **ITP narrative** relates coinciding with the **disclosure year** and forecast expenditure needs and outputs over the next **regulatory period**; (b) overview of the key assumptions and scenarios used to determine forecast expenditure and **grid outputs**; (c) assessment of the key uncertainties in the key assumptions, and forecast expenditure and **grid outputs**; (d) assessment of the key risks affecting forecast expenditure; (e) assessment of how the key uncertainties and key risks will affect **Transpower's** ability to deliver the forecast **grid outputs**; (f) description of the proposed measures to manage and mitigate the key uncertainties and key risks;
The Chorus Capex IM should address treatment of confidential information	While Chorus has emphasised elements of its capex proposals would be confidential and has argued a relevant factor is that unlike Transpower it faces competition from access seekers (RSPs), the Transpower Capex IM explicitly addresses confidential information[74] but the Chorus Capex IM does not. The clarification that "For the avoidance of doubt- (a) nothing … prevents the Commission publishing such information in respect of which it considers Transpower has no right to confidentiality"[75] should be transposed into the Chorus Capex IM.

[72] https://comcom.govt.nz/__data/assets/pdf_file/0034/197692/Chorus-Capex-IM-workshop-Clarification-questions-regarding-our-draft-decisions-and-our-responses-12-December-2019.pdf
[73] Transpower Capital Expenditure Input Methodology Determination 2012 (Principal Determination), 1 June 2018, Schedule E.
[74] Transpower Capital Expenditure Input Methodology Determination 2012 (Principal Determination), 1 June 2018, Part 7, Subpart 1, clause 7.1.2.
[75] Transpower Capital Expenditure Input Methodology Determination 2012 (Principal Determination), 1 June 2018, Part 7, Subpart 1, clause 7.1.2(2)(a).

10 Wholesale quality regulation will have a direct impact on end-users

An effective wholesale quality regime is critical to the quality of service that our customers receive. The Quality IM is thus a key area of concern for 2degrees.

This concern is shared across a range of access seekers. Given the importance of getting this right, and the limited time available, 2degrees have pooled resources and experience with Vocus, Vodafone and Spark to review and comment on quality issues. As such, in addition to our comments in this section, 2degrees supports the separate joint RSP submission on wholesale quality[76] which should be considered complementary to this submission.

The proposed light-touch approach

2degrees support the Commission's proposed quality dimensions and consider these provide a good basis from which to address key aspects of wholesale quality.

However, we do not consider the Commission' current proposed 'hands-off' approach to ensuring quality service within each of these dimensions is currently sufficient to protect competitive retail services under the new regime:

- The proposed approach is a much lighter touch than both the existing UFB contracts and regulatory regimes in comparable jurisdictions;
- We consider this is especially risky and inappropriate in the first regulatory period, which could be characterised as a 'try-and-see' phase given quality impacts of the new Part 6 regime are unlikely to all be apparent until the end of the second regulatory period;
- While the Commission has repeatedly referred to "potential increases in competition in" to justify a lighter approach to quality regulation, in our view it must respond to existing market conditions. Market power is a current condition to which the Commission must respond. This does not mean that the Commission can't scale back regulation if such competition does actually emerge.

End-user requirements must be at the forefront of any discussion regarding wholesale service quality. We consider the current underlying metrics are not adequate to support end user requirements and that:

- The metrics in the Quality IM will need to ensure appropriate standards and measures so that wholesale agreements with LFCs are able to support great quality services to consumers; and
- The quality information disclosure obligations must require detailed and regular reporting to support this.

The UFB contract terms are a useful starting point

The Commission has stated that the UFB contracts are out of the scope of the Quality IM, and PQ and ID regulation, to the extent that the contracts set requirements for wholesale services between third parties.

[76] Joint Submission on the quality aspect of the Commerce Commission's draft decision on the fibre fixed line access service input methodologies.

While the existing UFB contracts will not cover the full scope of FFLAS quality issues, they do include important terms critical to successful wholesale agreements. Given that PQ and ID determinations will flow directly from the new Quality IM, any concepts that are essential to those regulations meeting their Part 6 purpose must be considered at the Quality IM stage.

For this reason, we discuss the requirements of the UFB contracts in this submission. We also welcome the Commission's recognition that the UFB contracts will provide a useful starting point for ID and PQ regulation, and agree with the Commission that, any variance from UFB contract standards in quality determinations for the first regulatory period would require justification.[77]

Agreements between LFCs and Access Seekers need to be recognised by the quality regime

While wholesale agreements set obligations between third parties, in the light touch regime proposed by the Commission it is over simplistic not to recognise that they will also be the key mechanism by which quality standards are set and so play an enduring role in the quality of fibre products.

The Commission's proposed regime, which does not take account of this role, is at odds with a number of overseas jurisdictions who have recognised that without protection, firms with market power use their advantage to degrade quality related terms in wholesale agreements.[78] Most recently, Ofcom has imposed remedies on BT in four geographic areas where it found BT holds significant market power, including a requirement to publish a reference offer and to notify changes to charges, terms, conditions and technical information.[79] Ofcom gave the following reasons for imposing the remedy:

> Notification of changes to charges at the wholesale level has the joint purpose of improving transparency for monitoring possible anti-competitive behaviour and giving advance warning of price changes to competing providers who purchase wholesale access services.[80] …
>
> For the same reasons as outlined above, we consider that notifying changes to terms and conditions will lead to greater market stability, without which incentives to invest might be undermined and market entry made more difficult.[81]

A new 'change process' 'customer service metric should be introduced

Once the new Part 6 regime comes into force, LFCs will be motivated to negotiate quality related terms and conditions down (or not revise upwards) in order to save costs. This will become a problem when it affects the quality of services that end-users are able to access. In addition, the impact of these changes and their potential effects on end-users may not be readily apparent to those who are not access seekers. In our view, if LFCs are allowed to

[77] Commerce Commission, Fibre IM: Draft decision - reasons paper, 19 November 2019, paragraph 3.1546.
[78] For example Norway, Ireland, Hungry and Italy have all applied the BEREC guidelines set out in the BEREC, Common Position on best practice in remedies on the market for wholesale (physical) network infrastructure access (including shared or fully unbundled access) at a fixed location imposed as a consequence of a position of significant market power in the relevant market, which recommend that NRAs have oversight of the process for setting SLAs.
[79] Ofcom, Promoting competition and investment in fibre networks: review of the physical infrastructure and business connectivity markets, Volume 1: market analysis, SMP findings, and remedies for the Physical Infrastructure Market Review, 28 June 2019 at paragraph 4.120.
[80] Paragraph 4.124.
[81] Paragraph 4.126.

exploit their position of market power in this way, over time end-users will not receive the quality of service that they need, and the quality regime will not meet its legislative purpose.[82]

As set out in the joint submission, 2degrees support the Commission having oversight of the process by which LFCs set or change service descriptions, general terms or operational terms.

This can be done by including an additional metric under the customer service dimension. The specifications of the process can be set under the price-quality determination and information disclosure obligations can be used to check that the process is being followed.

This level of transparency would enable the Commission to ensure that LFCs are appropriately responsive to access seekers and are investing adequately to maintain quality of service for end-users.

The entire customer service dimension should be mandatory

Customer service is a dimension that will be of enduring importance to the quality regime. It is a dimension that tracks across the lifecycle of fibre products meaning that as the fibre network matures, it will remain crucial to the end-user experience.

We consider the customer service dimension, including the new 'change process' metric, must be a mandatory dimension for which PQ and ID determinations will apply: The degree to which regulated providers are responsive to access seekers has a direct link to outcomes for end users and we cannot foresee an instance where customer service is not essential to the quality of FFLAS supplied by wholesalers.

Information disclosure obligations are essential to ensuring a workable quality regime

Effective quality regulation will rely on appropriate information disclosure obligations. To encourage responsiveness to access seekers and appropriately support end-user requirements, the Information Disclosure requirements must:

- **Require regular, detailed ID reporting.**

  Regular reporting provides an up to date view of LFC responsiveness to access seekers. Regular reporting is also necessary in order to ensure that sufficient information is available to the Commission and other interested parties to assess whether the purpose of Part 6 is being met and identify what aspects need to be revised at the next reset.

- **Make disclosure of wholesale service agreement reference offers mandatory.**

  Disclosure of wholesale service agreement reference offers, which is consistent with the current approach under UFB, will make transparent any reduction in quality or level of service provided.

- **Ensure ID reporting includes an additional metric under which the Commission can monitor the process by which LFCs set or change service descriptions, general terms or operational terms.**

  Quality dimensions include responsiveness to both end users and access seekers.[83] We note the Commission has stated that responsiveness to access seekers will be captured by the customer service dimension. However, the only metric that relates to access

[82] Telecommunications Act 2001, s 162 (b).
[83] Telecommunications Act 2001, s 164.

seekers is focused on the “time to establish an access seeker”. This needs to be extended to ensure the quality regime incentivises LFCs to be responsive to access seekers or the Commission will compromise outcomes for end users. ID obligations should be used to monitor LFC compliance with the process that is set under the price-quality determination.

- **Include an ID requirement for a broad and detailed quarterly customer satisfaction survey.**

  A customer satisfaction survey directly motivates LFCs to take account of end user requirements and will help identify any areas of underinvestment. To be effective, the survey must be independent with terms of reference that are set by the Commission with input from access seekers. The survey must cover:

  - End user satisfaction across the lifecycle of the service (installs, faults, performance, available speeds, etc).
  - A breakdown of satisfaction scores for the top and bottom percentiles.
  - A breakdown of satisfaction scores by region and by product type.
  - RSP satisfaction with the relevant regulated provider. By including a section for RSP satisfaction, the Commission can help address the power imbalance between access seekers and regulated providers. Importantly RSPs may request changes to reflect evolving customer needs and innovation. Including due to the market power imbalance, 2degrees are concerned that such future requests will be appropriately considered, and in a timely, efficient manner.